Date of Hearing: January 7, 2014

ASSEMBLY COMMITTEE ON ARTS, ENTERTAINMENT, SPORTS, TOURISM, AND INTERNET MEDIA Ian C. Calderon, Chair

AB 1189 (Nazarian) – As Amended: March 19, 2013

SUBJECT: Income taxes: credits: qualified motion pictures

<u>SUMMARY</u>: Extends for five years the requirement that the California Film Commission (CFC) annually allocate tax credits to qualifying motion pictures, as specified, through the 2021-22 fiscal year and would also extend and increase the limit on the aggregate amount of credits that may be allocated through the 2021-22 fiscal year. Specifically, this bill:

- 1) Extends the requirement in law that that CFC annually issue tax credits to qualifying motion picture productions, as specified, through the 2021-22 fiscal year. (See Existing Law for a detailed explanation of the film tax credit program).
- 2) Extends the limitation on the aggregate amount of credits that may be allocated through the 2021-2022 fiscal year as follows:
 - a) \$100 million in credits for the 2009–10 fiscal year and each fiscal year thereafter, through and including the 2014-15 fiscal year.
 - b) \$150 million in credits for the 2015-16 fiscal year.
 - c) \$250 million in credits for the 2016-17 fiscal year and each fiscal year thereafter, through and including the 2021-22 fiscal year.

EXISTING LAW:

- 1) Establishes a motion picture production tax credit, equal to either:
 - a) 20% of the qualified expenditures attributable to the production of a qualified motion picture, or;
 - b) 25% of the qualified expenditures attributable to the production of a television series that relocated to California, or an independent film.
- 2) Defines "independent film" as a film with a budget between \$1 million and \$10 million produced by a non-publicly traded company which is not more than 25% owned by publicly traded companies.
- 3) Requires the CFC to administer a motion picture production tax credit allocation and certification program, as follows:

- a) Taxpayers will first apply to the CFC for a credit allocation, based on a projected project budget.
- b) Upon receiving an allocation, the project must be completed within 30 months.
- c) The taxpayer must then provide the CFC with verification of completion and documentation of actual qualifying expenditures.
- d) Based on that information, the CFC will issue the taxpayer a credit certificate up to the amount of the original allocation.
- 4) Defines "qualified motion pictures" as one produced for general distribution to the public, and include feature films with budgets between \$1 million and \$75 million; Movies of the Week with a minimum budget of \$500,000, and new television series with a minimum production budget of \$1 million licensed for basic cable and a television series that relocated to California.
- 5) Requires that in order to be eligible for the credit, 75% of the production days must take place within California or 75% of the production budget is incurred for payment for services performed within the state and the purchase or rental of property used within the state.
- 6) Declares that the credit is not available for commercial advertising, music videos, motion pictures for non-commercial use, news and public events programs, talk shows, game shows, reality programming, documentaries, and pornographic films.
- 7) Requires that the CFC allocate \$100 million of credit authorizations each year during the period 2009-10 through 2017 on a first-come, first-served basis, with 10% of the allocation reserved for independent films.
- 8) Declares that any unallocated amounts and any allocation amounts in excess of certified credits may be carried over and reallocated by the CFC.
- 9) Provides that qualifying taxpayers could claim the credit on their tax return filed with the Franchise Tax Board (FTB) under either the Personal Income Tax or Corporation Tax.
- 10) Provides further that taxpayers may use certified credits in a number of ways, they may;
 - a) Claim it directly;
 - b) Assign it to another member of their unitary group;
 - c) Sell the credits to other taxpayers, or;
 - d) Elect to apply the credit against their sales and use tax liability.

FISCAL EFFECT: Unknown

1) <u>Author's statement</u>: According to information supplied by the author, approximately 30 other U.S. states and overseas production companies offer enticing tax subsidies for film and TV

productions. Most notably, the state of New York has recently approved an aggressive \$420 million film incentive to increase and maintain film industry jobs in their state. According to industry advocates, from 2004-11, film and TV production in New York has risen 85% from 18 productions to 135. Productions and jobs that otherwise and potentially could have stayed in California, he asserts.

"In addition, many states, such as Louisiana, have no cap on this incentive at all, offering tax credits to any who would like to come to their state to shoot a film, a television show or even a pilot. Consequently, Louisiana's incentive has vaulted the state to become the third largest production destination within the US, creating more than 14,000 jobs and overall more than \$700 million in wages. The incentive affords productions up to 30% on all costs, with no annual cap. By comparison, California only offers a \$100 million annual incentive to productions with a budget lower than \$75 million.

"The result of this competition is, unfortunately, that California is no longer the home to the majority of film production. In the past decade, California's production has dropped to less than the 50% of the entire nation's production. In 2013, 11 of the 12 big action films expected to be the greatest box office draws were filmed outside of California. By contrast, in 2003, seven of the 12 summer films that grossed over \$100 million were shot primarily in California.

"The decline of productions all over the state hurt the local economies that no longer benefit from the business that the film industry brings. Local economies stand to lose millions in lost wages and business when producers decide to film elsewhere. Overall, productions that leave the state to pursue other state or international incentives - 'runaway productions' - translate to significant job and economic losses. In order to target productions most likely to leave California for other incentives offered, provisions in this bill create a greater appeal to do business in California."

2) <u>Current Film Production Tax Program</u>: The California Film & Television Tax Credit Program was enacted as a part of an economic stimulus plan to promote production spending, jobs, and tax revenues in California. The Program is administered by the CFC.

The credit first became available in July of 2009. Under existing statute, a qualified taxpayer is allowed a credit against income and/or sales and use taxes based on qualified expenditures. The credit amounts to either 20% or 25% of qualified expenditures, with a maximum of \$500 million dollars allocated total over the life of the program. The credit is not refundable. The credit may be carried over for five years and may be transferred to affiliates. Credits issued to independent films (\$1 million - \$10 million qualified expenditure budget that is produced by a company that is not publically traded and in which a publically traded company does not own more than 25% of the shares) may be transferred or sold to an unrelated party.

To be eligible for the credit, a project must meet the 75% test (production days or total production budget in California) and must be a qualifying motion picture.

For the purposes of a 20% tax credit, a qualifying motion picture is defined as:

a) A Feature Film (\$1 million minimum - \$75 million maximum production budget),

- b) A Movie of the Week or Miniseries (\$500,000 minimum production budget); or
- c) A new television series licensed for original distribution on basic cable (\$1 million minimum budget, one-half hour shows and other exclusions apply)

For the purposes of a 25% tax credit, a qualifying motion picture is defined as:

- e) A television series, without regard to episode length, that filmed all of its prior seasons outside of California; or
- f) An independent film.

In the 2009-10 fiscal year, which was the initial year of the program, \$200 million was allocated. In each subsequent year until the 2016-17 fiscal year, CFC will allocate \$100 million. A minimum \$10 million of the annual finding is made available for independent films.

- 3) Findings of Joint Oversight Hearings of the Assembly Arts, Entertainment, Sports, Tourism and Internet Media (AEST&IM) and Revenue and Taxation Committees: The California Film Tax Credit has been intensely studied by this Committee and the Assembly Committee on Revenue and Taxation. On March 21, 2011, a Joint Oversight Hearing of the Assembly AEST&IM and the Assembly Revenue and Taxation Committees was held on "California's Film Credit Under the Spotlight: A Review of the Film and Television Tax Credit Program." Following this hearing, the Revenue and Taxation Committee held another Oversight Hearing "Assessing Tax Expenditure Programs in Light of California's Fiscal Challenges" on February 22, 2012, where the Film Tax Credit was again analyzed. Most recently, the two committees held another Joint Oversight Hearing, "A Review of the California Film Tax Credit Program," on October 9, 2013. The findings of these hearings regarding the effectiveness of the Tax Credit Program have been fairly consistent. The following was taken from the White Paper prepared for the October 9, 2013 Joint Hearing.
 - a.) Arguments of Program Proponents: A report released by the Milken Institute states that, although "it is still too early to know the real impacts of the Film Tax Credit Program, there are some encouraging signs" that the Program is working. (K. Klowden, A. Chatterjee, and C. Flor Hynek, Film Flight: Lost Production and Its Economic Impact on California, Milken Institute, July 2010). Thus, in January of 2010, the Los Angeles Economic Development Commission (LAEDC) projected that, as a result of the California incentive program, production in the state would likely pick up in 2010. The projection by the LAEDC was bolstered by a report from Film L.A. (the permitting agency for Los Angeles). Film L.A. reported that, in 2010, feature film production posted a 28.1% fourth quarter gain and a year-over-year gain of 8.1%. In Film L.A.'s January 11, 2011 release, it was reported that the increase could be wholly attributed to the Film Tax Credit Program. The Program attracted dozens of new feature film projects to Los Angeles, and was responsible for 26% of the local feature production for the year. According to the CFC, these numbers are an early indicator that the Program is having an immediate positive impact on production in California.

The increase in production has resulted in increased revenues to the state as well as an increase in jobs. As reported by the CFC, approximately \$600 million in tax credits, including those conditionally allocated this year, has been allocated since the enactment of the Program. The total aggregate amount of direct spending is estimated to be \$4.7 billion, of which an estimated \$1.48 billion is attributable to qualified wages (excluding any wages for actors, directors, writers, and producers). Based on average aggregate spending by projects from each fiscal year, each \$100 million of allocated tax credits will generate \$792 million in direct production spending and cause productions to hire an estimated 8,500 cast and crew members. (CFC, *Progress Report*, July 2013).

Proponents also argue that California has a comparative advantage over other states because of its long established entertainment industry. This industry has provided California with a skilled workforce and ready infrastructure. It has been argued that this comparative advantage, when coupled with an incentive program, should be effective in keeping production in California, despite the fact that the California tax credit is not as generous as that of other states. In other words, an incentive program that is less costly than those provided in other states has the ability to keep production in California because of the various other benefits connected with filming in California.

b.) Arguments of Program Opponents: Despite the apparent success of increased film production and job growth, not everyone agrees with this use of state funds, raising several issues. Including, tax credits do not address the underlying issues (e.g., higher tax rates, regulatory impediments) that have led to California's sometimes challenging business climate. (San Jose Mercury News, *Hollywood tax break prompts debate over economy*, Tom Verdin, August 2012). Addressing these underlying issues, instead of allowing tax credits, may actually provide a more sustainable long term solution to the problem. In fact, according to a recent National Public Radio broadcast, "[s]tudies by think tanks across the political spectrum say states could get more bang for their buck with a general tax cut." (Julie Rose, *States Ponder Costs, Benefit of Film Incentives*, National Public Radio, Sept 2013).

Additionally, having states compete against one another is an unsustainable downward spiral that may eventually cause California to spend more money than necessary to retain or lure production. As noted by the Tax Foundation, "subsidizing anything gets you more of that thing." The appropriate question, therefore, is not whether production is increased but "whether the benefits of a given amount of net new job creation and the net new investment exceed the cost." (*Important Questions to Ask in Evaluating a Film Tax Incentive Program*, Tax Foundation, March 2012).

Opponents have argued that subsidies to the film and television industry benefit production that would have occurred in the absence of the incentive and that "much of the subsidy represents a real loss of revenue with no net new jobs to offset the cost." (M. Robyn, Tax Foundation, *Film Production Incentives: A Game California Shouldn't Play*, p. 1, a report presented at the Joint Oversight Hearing of the Committee on Revenue and Taxation and the AEST&IM Committee, March 21, 2011). Furthermore, in its 2009-10 Budget Analysis Series, the LAO noted that the credit is allocated on a first-come first-served basis, which undercuts the Program's incentive for production companies to change their location decisions. The firms that are "absolutely committed to producing in California would be among the first to apply for credits - before firms that are

considering an out-of-state location," and as a result, the credit "may be even more likely than most similar programs to create a windfall for committed in-state producers rather than be a deciding factor for otherwise-undecided producers." (2009-10 Budget Analysis Series, *Film Production Credit*, February 5, 2009).

4) Opposition: The California School Employees Association opposes this bill, based upon their belief that the program takes money away from important programs, including education, stating, "Over the past five years, the Legislature has faced daunting budget cuts during the budget deliberations. Painful cuts were made to vital programs that serve seniors and children. The education budget is barely held together on the premise that more revenues would materialize if voters passed Proposition 30. Yet despite these cuts, which have not been restored, we are able to give a tax break to the film industry.

"The non-partisan Legislative Analyst's Office (LAO) has provided many findings on the problems with this program. Here are the key, major findings (in a recent evaluation of the film tax program issued by the LAO for the Senate Governance and Finance Committee):

- "Assumptions Embedded in Methodology May Overstate Results. The LAO found that recent studies overstate the benefits. 'The lack of specific assumptions ... [which] is a frequent problem with this type of study and may result in the net benefit of the tax credit being dramatically over stated.' The LAO was referring to the recent study by the Los Angeles County Economic Development Corporation (LAEDC) touted by the industry.
- "Some Productions Stayed in California without the Need for a Tax Credit. The LAO also agreed with another study (The UCLA-IRLE) that in reality "some waitlisted productions proceeded anyway and were filmed in California without the credit."
- "Net Credit Benefit Likely Much Less Than Reported. A major finding by the LAO is that 'even if the combined state and local tax revenue return is right around \$1.00 for every tax credit dollar, the slate government's tax revenue return would by definition be less than \$1.00 for every tax credit dollar. The credit program, therefore, appears to result in a net decline in state revenues'."

"Our schools have suffered from \$20 billion in cuts over the past several years. Teachers and classified employees have been laid off by the tens of thousands and many more are furloughed. Every dollar we lose in state revenues means less funding for schools and other vital programs for seniors and children. For these reasons we must oppose AB 1189."

5) Prior and Related Legislation:

a) AB 286 (Nazarian) of the 2013-14 Legislative Session, would expand the definition of qualified motion pictures under the film tax program by removing the cap on the production budget for feature films and would limit the amount of qualified expenditures to \$75 million, as specified. This bill would additionally revise the amount of credits allocated by the CFC per fiscal year for a qualifying television series. AB 286 is currently pending before this committee.

- b) AB 2026 (Fuentes), Chapter 841, Statutes of 2012, extended the film production tax credit program for two additional years, until 2017.
- c) AB 1069 (Fuentes), Chapter 731, Statutes of 2011, extended the film production tax credit program for one year, until 2015.
- d) SB 1197 (Calderon), of the 2009-10 Legislative Session, deleted the fiscal year limitation on the existing film production tax credit. SB 1197 was held in Senate Revenue & Taxation Committee without a hearing.
- e) SBX8 55 (Calderon), of the 2009-10 Legislative Session, deleted the fiscal year limitation in the existing production tax credit. SBX8 55 was held in Senate Rules Committee without a hearing.
- f) ABX3 15 (Krekorian), Chapter 10, Statutes of the 2009-10 Third Extraordinary Session, established a five year \$500M tax credit for qualified expenditures on qualified productions. Limited allocations to \$100M/year.
- g) AB 855 (Krekorian), of the 2009-10 Legislative Session, established a film production tax credit. AB 855 was held at the Assembly Desk.
- h) AB 1696 (Bass), of the 2007-08 Legislative Session, established a financial assistance program within the CFC to encourage filming motion pictures and commercials in California and requires the Business, Transportation & Housing Agency to report the economic impact of this program by December, 2011. AB 1696 failed passage on the Senate Floor.
- i) SB 359 (Runner), of the 2007-08 Legislative Session, mega tax credit bill which included motion picture production credit. Part of State Budget negotiations. Created a credit for a percentage of the wages paid of amounts paid to purchase or lease tangible personal property in conjunction with the production of a qualified motion picture. The credit is certified and allocated by the CFC. The bill also allows the credit to be claimed against the sales and use tax liability of the company in lieu of the franchise or income tax liability. Finally, the bill allows the credit to be carried over until exhausted. SB 359 was held in the Senate Revenue and Taxation Committee.
- j) AB 832 (Bass), of the 2007-08 Legislative Session, created unfunded grant program administered by the CFC to encourage filming motion pictures and commercials in California. AB 832 was held on the Assembly Appropriations Committee Suspense File.
- k) SB 740 (Calderon), of the 2007-08 Legislative Session, created a film production credit equal to 100% of the direct revenues attributable to the production or 125% of the revenues of the productions in a TV series that relocated to California or an independent film as defined. SB 740 was held in Senate Revenue & Taxation Committee without a hearing.
- 1) AB 777 (Nunez), of the 2005-06 Legislative Session, authorized qualified motion picture tax credit in an amount equal to 12% of the qualified production for qualified wages paid with an additional 3% for qualified motion pictures. Created refundable credit. AB 777

was held in Senate Revenue & Taxation Committee without a hearing.

- m) SB 58 (Murray), of the 2005-06 Legislative Session, granted a refundable income or corporation tax credit equal to 15% of the amount of qualified wages paid and qualified property purchased in the production of a qualified motion picture. SB 58 was held in Senate Revenue & Taxation Committee.
- n) AB 261 (Koretz), of the 2005-06 Legislative Session, re-established funding for the Film California First Program. AB 261 was a gut and amend out in the Assembly Rules Committee and became a transportation bill.
- o) AB 1830 (Cohn), of the 2003-04 Legislative Session, authorized tax credits between 2006 and 2012 in an amount equal to 15% of qualified wages paid or incurred for services performed, with respect to the production of each qualified motion picture. AB 1830 was held in this Committee without a hearing.
- p) AB 1277 (Cohn), Chapter 662, Statutes of 2003, transferred administrative authority over the CFC to the Business, Transportation & Housing Agency. This bill also created the Film California First Fund, administered by the CFC, which provided for reimbursements to local governments for their costs in issuing permits for local filming of motion pictures. In the last two state budget cycles, no General Fund monies have been appropriated to operate this program.
- q) AB 2410 (Frommer), Chapter 1042, Statutes of 2002, required the CFC to report annually the number of motion picture starts that occurred within the State of California. The bill also required EDD to research and maintain data on film industry employment, to determine the economic impact of the film industry, to monitor film industry employment and activity and competing states and countries, to examine the ethnic diversity and representation of minorities in the entertainment industry, to review the effect of federal, state and local laws on the filmed entertainment industry and to report that information to the legislature biannually, provided that funds are appropriated by the legislature in the annual Budget Act for these purposes.
- r) AB 2747 (Wesson), of the 2001-02 Legislative Session, provided a tax incentive to produce motion pictures within California. Would offer tax credits to productions with a total cost of qualified wages between \$200,000 and \$10 million for 15-25% of wages paid to qualified individuals during the taxable year with respect to qualified motion picture production depending on the area. For each motion picture, the maximum amount of wages per qualified individual that could be taken into account when computing the credit was \$25,000. AB 2747 failed passage in the Senate Appropriations Committee.
- s) SB 2061 (Schiff), Chapter 700, Statutes of 2000, created the State Theatrical Arts Resources (STAR) partnership which offers surplus State property to filmmakers, where unused State properties, such as health facilities and vacant office structures, are available at no charge or "almost free" to filmmakers.
- t) AB 358 (Wildman & Kuehl), of the 1999-2000 Legislative Session, provided a refundable income and corporation tax credit for 10% of eligible wages paid for motion pictures and TV programs produced in California. AB 358 was held on the Senate

Appropriations Committee Suspense File.

- u) AB 484 (Kuehl), Chapter 699, Statutes of 1999, created the Film California First program, housed at the California Film Commission to reimburse certain film costs incurred by a qualified production company when filming on public property, but which is currently unfunded.
- 6) <u>Double-referral</u>: Should this bill pass out of this committee, it will be re-referred to the Assembly Committee on Revenue and Taxation.

REGISTERED SUPPORT / OPPOSITION:

Support

Valley Industry and Commerce Association

Opposition

California School Employees Association

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